

1942

Securities and Exchange Commission today issued an opinion in its Accounting Series dealing with certain accounting aspects of the recent amendments to Forms 10-K and N-30A-1, the principal annual reporting forms under Section 13 of the Securities Exchange Act

United States. Securities and Exchange Commission

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Recommended Citation

United States. Securities and Exchange Commission and Werntz, William W., "Securities and Exchange Commission today issued an opinion in its Accounting Series dealing with certain accounting aspects of the recent amendments to Forms 10-K and N-30A-1, the principal annual reporting forms under Section 13 of the Securities Exchange Act" (1942). *Federal Publications*. 130.

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For Release in MORNING Newspapers of Tuesday, December 22, 1942

SECURITIES AND EXCHANGE COMMISSION
Philadelphia

SECURITIES ACT OF 1933

Release No. 2889

SECURITIES EXCHANGE ACT OF 1934

Release No. 3349

INVESTMENT COMPANY ACT OF 1940

Release No. 421

ACCOUNTING SERIES

Release No. 41

The Securities and Exchange Commission today issued an opinion in its Accounting Series dealing with certain accounting aspects of the recent amendments to Forms 10-K and N-30A-1, the principal annual reporting forms under Section 13 of the Securities Exchange Act. These amendments, which were adopted in connection with recent revisions of the rules governing proxy solicitations, permit companies to file copies of their regular annual reports to stockholders in place of certain of the financial statements required to be filed by such forms, if the financial statements included in the annual report to stockholders substantially conform to the requirements of Regulation S-X, the underlying accounting regulation of the Commission. The opinion, prepared by William W. Werntz, Chief Accountant, indicates that while the financial statements included in reports to stockholders are frequently somewhat more condensed than those filed in accordance with the requirements of those forms and Regulation S-X, such condensation, if limited to the grouping of items that are not substantial in amount or otherwise material because of their particular origin or nature, would not prevent the filing of such financial statements in place of those required by the instructions.

The full text of the opinion follows:

"A recent amendment of Form 10-K provides that in partial response to the requirements for filing financial statements a registrant may if it wishes file a copy of its regular annual report to stockholders and incorporate by reference the financial statements contained in such report. This procedure may be followed, however, only if the financial statements included in the report to stockholders substantially conform to the requirements of Regulation S-X. Of course, any financial statements or schedules required by the instructions that are not included in the stockholders' report must also be furnished.

"A review of numerous stockholders' reports covering the year 1941 indicates that in many cases the financial statements included are identical with those filed subsequently as part of the annual report on Form 10-K except that a number of relatively minor items shown separately in the report on Form 10-K are grouped, or combined with closely similar items in the report to stockholders. Inquiries have been received as to whether, where condensation of this type exists, the statements may nevertheless be considered to conform substantially to the requirements of Regulation S-X.

"The provisions of Article 5 of Regulation S-X contain a general statement of the details to be shown in balance sheets and income statements filed by commercial and industrial companies. Such requirements are, however,

supplemented by and subject to the general rules contained in Article 3. Rule 3-06 thereof provides, on the one hand, that, in applying the requirements to the circumstances of an individual case, there shall be given, in addition to the required information, such further information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading. On the other hand, Rule 3-02 provides that, if the amount to be shown under any particular caption is not significant, the caption need not be separately set forth. The effect of these two general requirements is to require the disclosure of significant information not specifically called for, but to permit the omission of information, even though covered by a specific requirement, if the item involved is not significant. It should be pointed out, however, that in some cases the significance of an item may be independent of the amount involved. For example, amounts due to and from officers and directors, because of their special nature and origin, ought generally to be set forth separately even though the dollar amounts involved are relatively small. Likewise, disclosure of the various types of surplus, the important reserve accounts, and, under present conditions, the accrued liability for taxes is of importance. In the same way, in the corporate income statement of a company having large investments in subsidiaries or in the securities of unaffiliated companies, the disclosure of income from dividends and interest is necessary irrespective of the amount, since the absence or smallness of dividend and interest income is of as great importance as the exact amount thereof. In the income statement generally, it is important that the major elements such as sales and cost of sales, substantial items of other income and income deductions, and the provision for income and excess profits taxes be separately disclosed, unless to do so would violate the provisions of the Code of Wartime Practices. Finally, care should be taken that the necessary descriptive and explanatory footnotes applicable to the particular statements are set forth.

"On the other hand, the combination under a miscellaneous caption of minor items among the current assets or liabilities resulting from the ordinary course of business, or their combination with closely similar items that are large in amount, is, in my opinion, permissible and, where minor items are numerous, would tend to improve the legibility of the statements. Similar combinations appear to be permissible within the other major categories of items customarily appearing in the financial statements, such as deferred charges, prepaid expenses, and fixed assets. Generally, however, condensation in the balance sheet would not appear appropriate with respect to an item amounting to more than 10% of its immediate category, such as deferred charges, or more than 5% of total assets. Where, however, the immediate category is less than 5% of total assets, it would generally appear permissible to combine all components of the category under a suitable caption.

"If such condensation as may exist in the financial statements included in the regular annual report to stockholders has been made along the lines indicated, such financial statements would in my opinion substantially conform to the requirements of Regulation S-X and could therefore, under the recent amendment to Form 10-K, be incorporated by reference in annual reports on that form. Of course, care should be taken that the captions used are not such as to be misleading."

Form N-30A-1, the annual report form for investment companies subject to the Investment Company Act of 1940, has been amended in the same manner as Form 10-K. While the discussion above relates to the financial statements of commercial, industrial and utility companies using Form 10-K, comparable principles are applicable to investment companies using this form.